

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

<b>Illinois Commerce Commission</b>	)	
<b>On its Own Motion</b>	)	
<b>-vs-</b>	)	
<b>Northern Illinois Gas Company</b>	)	<b>Docket No. 03-0703</b>
<b>d/b/a Nicor Gas Company</b>	)	
	)	
<b>Reconciliation of revenues collected under</b>	)	
<b>Gas adjustment charges with actual costs</b>	)	
<b>Prudently incurred.</b>	)	

**DRAFT ORDER OF THE CITIZENS UTILITY BOARD  
AND THE PEOPLE OF THE STATE OF ILLINOIS**

**June 8, 2015**

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The Citizens Utility Board, (“CUB”), by and through its counsel, and The People of the State of Illinois by Attorney General Lisa Madigan (“AG”), (collectively “CUB-AG”), pursuant to 83 Ill. Admin. Code § 200.810, and the schedule adopted by the Administrative Law Judge (“ALJ”), hereby file this Draft Order regarding the reconciliation of revenues of Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor”) incurred under its Purchased Gas Adjustment (“PGA”) clause during 2003.

This is the first PGA proceeding after Nicor’s alternative regulation program, known as the Gas Cost Performance Program (“GCPP”), which was in effect from January 1, 2000 through December 31, 2002. The Commission reviewed the GCPP results in Docket No. 02-0067 (cons). CUB avers that the twelve year delay in the instant proceeding is due primarily to the fact that it was necessary to first complete Docket No. 02-0067 in order to effectively litigate this proceeding. The Commission entered an order in that docket on June 5, 2013, which included a customer refund in the amount of approximately \$72 million. A schedule commenced with this proceeding shortly thereafter.

CUB-AG initially point out the long history of this docket. Nicor initially filed direct testimony in this proceeding on March 1, 2004, but Nicor later filed revised and supplemental direct testimony of two witnesses (Leonard Gilmore, Nicor Ex. 1.0 Revised, and Bob Buckles, Nicor Ex. 3.0), on August 29, 2013. On November 21, 2013, CUB filed direct testimony of Mr. Jerome Mierzwa, (CUB Ex. 1.0), and Staff filed direct testimony of Ms. Mary Everson (Staff Ex. 1.0), and Mr. Mark Maple (Staff Ex. 2.0). Nicor filed rebuttal testimony from the same two witnesses who filed direct testimony, Leonard Gilmore (Nicor Ex. 4.0) and Bob Buckles (Nicor Ex. 5.0), on May 9, 2014 (a total of 24 pages). On August 7, 2014, Staff filed rebuttal testimony of Ms. Everson, Staff Ex. 3.0, and Mr. David Rearden, Staff Ex. 4.0, and CUB filed rebuttal

testimony of Mr. Mierzwa, CUB Ex. 2.0. Nicor then filed 68 total pages of surrebuttal testimony from four witnesses on December 5, 2014: Timothy Sherwood, Christopher Gulick, Sherman Elliot, and Bob Buckles. On March 3, 2015, CUB filed a Motion to Strike the Surrebuttal testimony of Nicor witness Elliot. The motion was granted on March 16, 2015. None of the witnesses who submitted surrebuttal testimony on behalf of Nicor had personal knowledge of the events that took place in 2003.

CUB Witness Mierzwa has significant experience in the natural gas industry, working in various positions since 1986, including in the rate department of National Fuel Gas Supply Corporation, where he prepared PGA filings and developed interstate pipeline and spot market supply gas price projections. CUB Ex. 1.0 at 1:18-23. Since 1990, Mr. Mierzwa has worked at Exeter Associates and has provided testimony on more than 100 occasions in proceedings before the Federal Energy Regulatory Commission (“FERC”), utility regulatory commissions in Delaware, Georgia, Indiana, Louisiana, Maine, Maryland, Montana, Nevada, New Jersey, Ohio, Pennsylvania, Rhode Island, Texas and Virginia, as well as before this Commission. *Id.* at 2:36-40. Mr. Mierzwa specializes in evaluating the gas purchasing practices and policies of natural gas utilities, utility class cost of service and rate design analysis, sales and rate forecasting, performance-based incentive regulation, revenue requirement analysis, the unbundling of utility services and evaluation of customer choice natural gas transportation programs. *Id.* at 2:29-33.

### ***Nicor’s Gas Procurement Activities***

CUB-AG explain that Nicor relies on natural gas stored in underground aquifer storage fields to meet both daily and seasonal winter peak load requirements of its sales customers. Nicor Ex. 1.0R at 9:188-189. Storage is a natural hedge that reduces volatility in the cost of gas to Nicor Gas’ customers. Nicor Ex. 1.0R at 251-252. In addition to stored gas, Nicor also uses various supply contracts through interstate pipelines and other third parties, consisting of spot purchases and firm gas supplies.<sup>1</sup> Nicor also provides a number of services to third-parties utilizing its natural gas transmission, distribution and storage facilities. CUB Ex. 1.0 at 3:56-67. These services include firm and interruptible storage, and park and loan services. CUB collectively refers to these services as “Hub services.” *Id.* Under a park transaction, a third-party delivers gas to Nicor at one point in time and that gas is returned to the third-party at a future point in time. *Id.* A loan transaction is just the opposite, with Nicor delivering gas to the third-party at one point in time and the third-party returning that gas to Nicor at a future point in time. *Id.* Park and loan deliveries are commonly made over a one-month period with the same fixed daily quantity being delivered on each day, either to Nicor or the third-party. *Id.* Although similar, park and loan transactions differ from a storage service in that a storage service generally provides for varying daily delivery quantities to or from Nicor. *Id.*

CUB-AG further explain that Sales customers (customers taking Nicor’s gas supply) pay for the gas they use through Nicor’s PGA. *Id.* at 3:69-74. The costs associated with Nicor’s storage facilities are paid for by ratepayers through base rates. *Id.* Hub revenues generated using assets paid for by sales customers (*e.g.*, interstate pipeline capacity) are credited to purchased gas

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<sup>1</sup> Firm gas supplies are generally priced on market-based indices and are evaluated on the basis of a variety of factors, including index premium, reliability, diversity of supply source and flexibility. Nicor Ex. 1.0R at 10:215-217.

costs (PGA Hub revenues). *Id.* Hub revenues generated using assets paid for through base rates are retained by Nicor (Non-PGA Hub revenues) unless and until those revenues are included in a revenue requirement later approved by the Commission. *Id.* at 4:75-76.

During the reconciliation period, CUB-AG aver that Nicor provided Hub storage, park and loan services to generate Non-PGA Hub revenues, which negatively affected the Company's storage inventory levels and the amount of gas available for withdrawal during 2003. *Id.* at 4:80-87. CUB-AG maintain that these loan transactions reduced the amount of on-system storage gas that was available for PGA customers in the winter of 2003, which had an adverse impact on the purchased gas costs of PGA customers. *Id.* at 4:80-87. As a result, argue CUB-AG, Nicor was forced to purchase more high cost gas during February and March 2003 because gas in storage was utilized to provide third-party Hub services. *Id.* at 5:105-107. CUB witness Mierzwa calculated a disallowance in the amount of approximately \$22 million to account for the impact of this imprudent activity. Similarly, Staff witness Rearden found that Nicor's provision of Hub loans raised PGA gas costs by \$18 million. Staff Ex. 4.0 at 3:44-46.

## LEGAL STANDARD

CUB-AG point out that Section 9-220 of the Public Utilities Act ("PUA") requires the Commission to initiate annual hearings to determine whether the actual gas costs a utility charged through its PGA during the reconciliation period for which the Company seeks recovery through its purchased gas adjustment clause ("PGA") were reasonable and prudently incurred. The PGA clause provides for increases or decreases of the rates or charges of a public utility such as Nicor based on changes in its cost of purchased gas. 220 ILCS 5/9-220. CUB-AG note that, although the PGA clause allows for automatic changes in rates without prior Commission approval, the General Assembly requires that the Commission initiate annual hearings to determine whether the clauses reflect the "costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent." 220 ILCS 5/9-220(a).

CUB-AG explain that prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. *Illinois Power Co. v. Illinois Commerce Comm'n*, 245 Ill.App.3d 367, 371, (1993). CUB-AG agree with Staff & Nicor that, when a court considers whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. *Illinois Power Co.*, 245 Ill.App.3d at 371. Only what Nicor decision-makers actually analyzed or should have analyzed can be considered; hindsight review is impermissible. *Id.*

Nothing in Section 9-220 of the Act, or the prudence standard, however, contradicts the Act's overarching policy that public utility service be provided at least-cost. 220 ILCS 5/1-102. Furthermore, CUB-AG note that, under the Commission's Administrative Code, recoverable gas costs include the costs of gas, costs of storage, transportation costs and other non-commodity costs. 83 Ill. Adm. Code 525.40(a). Any revenues derived from any transactions with costs associated with costs recoverable under this section (including PGA Hub revenues) must be used to offset those costs. *Id.* at 525.40(d). When engaging in such transactions, CUB-AG aver that utilities must "refrain" from doing anything that would increase the gas charge. *Id.*

CUB-AG maintain that the purpose of this proceeding is to determine whether the purchased gas costs recovered by Nicor during the reconciliation period, January 1, 2003 through December 31, 2003 (“2003 reconciliation period”), were reasonably and prudently incurred, per Section 9-220. No party contests that this provision unequivocally places the burden of proof of all material issues squarely and exclusively on the utility. 220 ILCS 5/9-220(a). Thus, while Nicor passes its gas costs directly to ratepayers without a markup or profit under the PGA, it still must demonstrate that its costs of purchasing and managing the gas were prudently incurred. *Id.*

#### STORAGE ADJUSTMENT

CUB witness Mierzwa and Staff witness Rearden each propose a disallowance to account for Nicor’s imprudent use of storage gas for third parties instead of sales customers. *See* CUB Ex. 1.0, 2.0; *see also* Staff Ex. 4.0. During the 2003 reconciliation period, say CUB-AG, Nicor engaged in Hub transactions that had the effect of reducing the amount of on-system storage available for sales customers. Mr. Mierzwa and Mr. Rearden each concluded that this practice was imprudent because, as a result of using gas in storage to provide these third-party Hub services, Nicor was required to purchase more high cost gas during February and March 2003, and therefore Nicor’s actions raised gas costs. Mr. Rearden concluded that Nicor’s provision of Hub services during the reconciliation year was imprudent because, rather than use the storage withdrawals to supply sales customers with the PGA gas, it delivered the withdrawn storage gas to Hub customers to generate revenues that did not offset PGA costs. Staff Ex. 4.0 at 18:378-382. Staff maintains that Nicor loaned gas that was expensive and was repaid with gas that was cheaper. *Id.* Mr. Rearden’s conclusion and ultimate disallowance recommendation, while calculated differently, are substantially similar to that of CUB witness Jerome Mierzwa.

CUB-AG note that, to serve its sales customers during the winter, the Company can purchase gas that is delivered directly to its system, or withdraw gas from storage. As Nicor witness Gilmore testified, storage is used to meet both daily and seasonal winter peak load requirements of its sales customers, and operates as a natural hedge that reduces volatility in the cost of gas to Nicor Gas’ customers. Nicor Ex. 1.0R at 9:188-189, 251-252. CUB-AG aver that this is because summer gas prices are typically lower than winter gas prices. CUB. Ex. 2.0 at 3:45. In fact, say CUB-AG, in late February and early March 2003, gas prices did increase significantly. During this period, CUB-AG argue that the Company withdrew gas from storage to accommodate its third-party Non-PGA revenue Hub services instead of relying more heavily on gas from storage to serve its sales customers. According to CUB-AG, therefore, Nicor was required to purchase more high cost gas during February and March 2003 to serve sales customers because gas in storage was utilized to provide third-party Hub services.

CUB-AG state that whether the Company knew precisely what gas prices would do in the winter of 2003 is not at issue. As CUB witness Mierzwa explained, “it is consistently the general expectation that winter gas prices will be higher than summer gas prices.” CUB Ex. 2.0 at 3:45. The reluctance of Nicor witnesses to acknowledge this most basic, widely understood concept is simply absurd to CUB. CUB-AG show that the evidence in the record clearly undermines Nicor’s denial of this reality which is its only defense to Mr. Mierzwa’s adjustment. As Mr. Mierzwa testified, former Nicor witness Gilmore conceded in a data response that winter prices are normally higher than summer prices. CUB Ex. 2.0 at 3:6-7, citing to Nicor’s Response to CUB 5.05). Further, note CUB-AG, Nicor witness Gilmore (whose testimony is adopted by

Mr. Sherwood) admits that the purpose of storing gas is to moderate (or hedge against) volatility in the cost of gas to Nicor Gas' customers. Nicor Ex. 1.0R at 251-252. This point alone demonstrates the general proposition discussed by CUB-AG that summer gas prices are at the very least less volatile than winter gas prices.

CUB-AG note that Nicor witness Sherwood refused to acknowledge (the obvious general statement) that summer gas prices are typically lower than winter gas prices while on cross-examination, but he did at a minimum acknowledge that "the NYMEX Futures Market prices quoted for the winter are higher than they are in the summer." March 17, 2015 tr. at 40:10-12. CUB-AG further point out that Mr. Sherwood also agreed that "Nicor typically follows a pattern of injecting gas into its storage fields in the summer and withdrawing that gas to serve customers in the winter." *Id.* at 16-19.

***Mr. Mierzwa's Disallowance Proposal Does Not Require Hindsight.***

CUB-AG maintain that the Commission's review in this proceeding, under the prudence standard, should review the Company's decisions to engage in the Hub transactions in light of whether Nicor could reasonably be expected to know that, at the time the Company made its decisions, buying gas at winter market prices would cost more than using gas from storage, which was purchased at lower summer prices. Since it is consistently the general expectation that winter gas prices will be higher than summer gas prices, say CUB-AG, it was unreasonable for Nicor to decide to provide Hub loan services in February and March 2003. According to CUB-AG, because gas prices in February and March 2003 were much higher than expected, the adverse *impact* on PGA customers was greater than expected, but the simple fact that winter gas prices were higher should not have come as a surprise to Nicor. CUB-AG aver that the magnitude of the increase in gas prices is only relevant to the calculation of the disallowance. Quite simply, CUB-AG point out that Nicor should have known – at the time it made the decision to engage in Hub loans in February and March 2003 – that such activity would result in less stored gas being available for sales customers. At that time, because it could have reasonably been expected that gas prices would be higher than the cost of the stored gas, CUB-AG conclude that Nicor should have known such actions would result in higher gas costs for sales customers than in the absence of such Hub loans. No hindsight is required, according to CUB-AG.

CUB-AG note that Nicor is permitted to conduct Hub transactions under tariff, but it is not required to. In fact, CUB-AG maintain that the Act prohibits Nicor from engaging in transactions that raise gas costs in an imprudent manner. See 220 ILCS 5/1-102, 83 Ill. Adm. Code 525.40(d). As Mr. Mierzwa testified, "[i]t is not unreasonable for Nicor to utilize its storage facilities to generate base rate revenues as long as those storage activities do not increase costs for ratepayers." CUB Ex. 1.0 at 5-6:123-127. CUB-AG argue that it is imprudent for the Company to engage in activities that increase gas costs for ratepayers if the Company could have reasonably foreseen that engaging in the Hub transactions it did during February and March 2003 would reduce the amount of storage gas available to sales customers. CUB-AG point out that Mr. Sherwood agreed that, all else equal, on one particular day, "if more demand is served out of storage...less [is] needed on flowing supply," (March 17, 2015 tr. at 50:6-8). Thus, claim CUB-AG, it is axiomatic that if Nicor had withdrawn more gas from storage in the winter of 2003, it would have needed to purchase less flowing supplies. CUB-AG aver that no hindsight is needed

for Nicor to understand – at the time the decisions were made – that by engaging in Hub loans in February and March 2003, Nicor was reducing the amount of gas it could withdraw for sales customers. By engaging in these transactions, conclude CUB-AG, Nicor subjected its customers to historically high gas prices when such market purchases could have been mitigated by using that stored gas for ratepayers.

***Operational Concerns Do Not Account for the Significantly Increased Hub Activity in 2003***

CUB-AG question Nicor's claim that the Hub transactions at issue contributed to cycling its storage, because Nicor did not produce any cost analysis, sensitivity analysis or studies to support the amount of storage it allocated to the Hub during 2003 for operational reasons. Nor did Nicor provide any evidence to support Mr. Sherwood's bald claim that "prohibiting Hub loans or other Hub-related withdrawals may well have resulted in Nicor Gas being unable to cycle its on-system storage inventory, and potentially damage a valuable asset that provides benefits to Sales customers." Nicor Ex. 6.0 at 86-89. CUB-AG therefore maintain that such a statement has no support in this record.

In fact, according to CUB-AG, the record is clear that not only is the use of Hub transactions not necessary to cycle storage, the amount of storage dedicated to Hub loans had historically been a fraction of the amount assigned to Hub transactions in 2003. First, CUB-AG show that Mr. Sherwood agreed on cross-examination that withdrawing more gas to serve sales customers in February and March would have contributed to cycling the storage field. March 17, 2015 tr. at 59:8-10. Second, CUB-AG explain that an undated company memo from Maureen Williams to Neal Maloney, in response to the question "is there an operational need for loans," was that: "it depends. I would say there is not an operational need for loans, there is a need to cycle the reservoirs to maintain operational integrity and reliability of delivery. Loans provide a benefit to assist in ensuring a deeper cycle from the cycle without loans." Nicor Ex. 7.3 at 27. Third, CUB-AG point to a November 16, 1998 company memo from Dave Brown to Mr. Len Gilmore, which was included in Nicor witness Gulick's Exhibit 7.3, indicated that Hub loans have traditionally been of the magnitude of 1 or 2 Bcf per year and "at that level, Nicor can confidently offer reasonable daily withdrawal and injection rates while still maintaining the ability to meet other obligations, including interruptible Hub activity." *Id.* at 25-26. CUB-AG state that the total amount of storage Nicor devoted to Hub services in the winter of 2002-2003 was 26 Bcf, or at least 13 times the amount that Nicor indicated could effectively cycle its storage field and remain operationally sound. CUB-AG aver that Nicor presented no evidence that circumstances in 2003 demanded 26 Bcf be devoted to Hub services, what can only be described as an extraordinary increase in the amount of storage allocated to Hub services from historic practice.

***Nicor Could Not Justify the Amount of Hub Loans Made in February and March 2003***

During the summer of 2002, CUB-AG say the evidences shows that Nicor accepted gas from third-parties for Non-PGA revenue Hub services, injected that gas into its on-system storage facilities, and withdrew and returned that gas to those third-parties by February 11, 2003. *Id.* In total, CUB-AG note that Nicor withdrew almost 17,000,000 Dth (17 Bcf) during the period January through March 2003 to accommodate its Non-PGA revenue Hub services. CUB

Ex. 1.0 at 5:110-119. CUB witness Mierzwa identified that nearly 8 Bcf which was loaned (advanced) to these third-parties was included in this amount, and repaid at a point in the future. *Id.* Also, state CUB-AG, Nicor injected more than 9 Bcf of gas into storage on behalf of third-parties to support its Non-PGA revenue Hub services prior to the winter of 2002-2003, and withdrew and returned all of that gas to those third parties during January and February 2003. *Id.* In addition to these transactions, CUB-AG maintains that the evidence shows that Nicor withdrew an *additional* 8 Bcf of gas from storage during February and March 2003, which it delivered to third-parties who returned that gas the following summer. *Id.* CUB-AG note that Nicor witness Sherwood confirmed that, as of March 31, 2015, Nicor had advanced almost 8 Bcf more gas to Hub customers than it had received from Hub customers. March 17, 2015 tr. at 51:6-8. Mr. Mierzwa's adjustment only includes this 8 Bcf of Non-PGA revenue Hub services that was advanced, because it was discretionary and should have been avoided at a time when gas prices increased significantly.

CUB-AG state that, in addition to the 8 Bcf of gas loaned to third-parties in conjunction with Non-PGA revenue Hub services, Nicor accepted 18 Bcf from third-parties during the summer of 2002, (9 Bcf to support Non-PGA revenue Hub services and 9 Bcf to support PGA revenue Hub services), which was returned during the winter of 2002-2003. Thus, in total, Nicor used 26 Bcf of storage to support its Hub services during the winter of 2002-2003, according to CUB witness Mierzwa. CUB-AG maintain that Nicor has presented no studies to show that using 26 Bcf or even 18 Bcf of storage to support Hub services rather than to serve sales customers was a prudent use of stored gas. Nonetheless, Mr. Mierzwa conservatively proposed a disallowance for only the 8 Bcf of gas Nicor advanced to third parties in February and March 2003.

CUB-AG aver that Nicor could have allocated a larger portion of its storage to sales customers for the reconciliation year. Nicor witness Gulick acknowledged that transportation customers did not fully utilize the storage they were entitled to use (the amount of storage Nicor allocated to those customers) during the reconciliation period. March 17, 2015 tr. at 116:20-22-116:1-2. In Mr. Gulick's Ex. 7.4, an internal analysis discussing storage allocations, Nicor stated that:

There is approximately 7 bcf of space unallocated from the current storage allocation plan. This can either go to the Hub or to the utility. I recommend the volume be allocated to the Hub to reduce the volume of gas the ratepayers need to pay to support their burn requirements and still take advantage of the gas in storage for the next heating season.

Nicor Ex. 7.4 at 6. CUB-AG conclude that this memo demonstrates that the Company used discretion to determine how unallocated storage space would be used, and that it could have been used for ratepayers. According to CUB, there is no indication that this additional storage was necessary for cycling.



***Nicor's Other "Explanations" for Its Failure to Withdraw More Stored Gas for PGA Customers Consist of Post-hoc Conjecture***

CUB-AG state that, in attempting to discredit Mr. Mierzwa's proposal, Nicor witness Gulick claims that Mr. Mierzwa "does not understand the difference between storage inventory and storage deliverability." Nicor Ex. 7.0R at 15:303-304. Mr. Gulick's claim that a "more plausible and straightforward explanation" for why Nicor Gas did not withdraw additional gas from storage to serve the demand of PGA customers is either that "Nicor had already committed to a planned dispatch, which likely included set quantities of firm pipeline purchases, or there was insufficient PGA demand." Nicor Ex. 7.0R at 15:310-313. Setting aside for a moment the obvious point that Mr. Gulick presented no direct evidence or personal knowledge that this was, in fact, the case, CUB-AG argue that Mr. Gulick's main basis for this assumption was not supported. CUB-AG note that Mr. Gulick points to the "fact" that most of the gas purchased in these two months was firm gas that was previously contracted to be delivered on a firm basis to support his point. *Id.* at 26:466-467. CUB-AG counter argue that, when questioned on cross-examination, Mr. Gulick did not know what Nicor's obligations were with respect to the contracted firm gas, and admitted that he had not investigated whether Nicor was obligated to purchase that gas. March 17, 2015 tr. at 136:12-22-137:1-2. Thus, CUB-AG conclude that Mr. Gulick's claim that Nicor's spot gas purchases were not abnormally high in February and March, because of these firm supplies, (*id.* 25:461-465), should be disregarded. Additionally, according to CUB-AG, Mr. Gulick's claim that "a lower overall aquifer inventory level does not result in a one-for-one reduction in the ability to withdraw gas from the storage fields," (Nicor Ex. 7.0R at 15:306-308), is incongruous with other Nicor testimony that, all else equal, on one particular day, "if more demand is served out of storage...less [is] needed on flowing supply." March 17, 2015 tr. at 50:6-8 (Sherwood).

**DISALLOWANCE CALCULATION**

CUB-AG states that, to calculate his disallowance, Mr. Mierzwa assumed that the gas Nicor took out of storage and loaned to third-parties was used to displace purchases made by Nicor during February and March 2003, and the gas withdrawn was replaced the following summer (April-October 2003). CUB Ex. 1.0 at 6:139-144. CUB-AG note that Mr. Mierzwa's calculation uses the difference between the average price paid for gas by Nicor during February and March 2003, and the average price paid for gas purchased the following summer, and multiplies the difference by the amount of gas loaned to third-parties, which calculated the adverse impact on sales customers to be \$22.2 million. CUB-AG maintains that this adjustment is based on the high cost gas purchases that could have been avoided had the Company not loaned gas in conjunction with its Non-PGA revenue Hub services during February and March 2003. According to CUB-AG, this calculation represents a reasonable methodology to account for the impact on rates of Nicor's imprudent storage activity.

CUB-AG explain that Mr. Mierzwa used this "average cost" approach for two reasons. First, CUB avers that to ideally determine the adverse impact of providing these Hub services, one would examine the purchases made by Nicor on each day during the period February 11 through March 31, 2003, purchases which Nicor could have avoided, to determine the impact of Nicor's Non-PGA revenue Hub services. CUB Ex. 1.0 at 6-7:148-154. However, says CUB,

that process would be extremely difficult more than ten years after the fact, as Nicor made hundreds of purchases during that period. *Id.*

Second, CUB-AG note that Mr. Mierzwa used this average cost approach to arrive at a conservative estimate of the adverse impact of Nicor's Non-PGA revenue Hub services. *Id.* at 7:155-165. CUB-AG explain that Nicor began loaning gas to third-parties on February 11, 2003, and gas prices increased significantly during the period of February 21 through March 11, 2003. *Id.* By using the average price for gas purchased by Nicor during February and March 2003, say CUB-AG, the relatively lower cost purchases made by Nicor during the period February 1-10, 2003 are included in his adjustment, thus making it conservative. *Id.* Moreover, CUB-AG argue that since gas prices declined to much lower levels after March 11, 2003, and the daily quantities loaned to third parties also declined, Mr. Mierzwa's methodology is conservative because it disregards the fact that more gas purchases would have been displaced when prices were higher than when prices were lower. *Id.* That is, Mr. Mierzwa's adjustment does not account for the fact that more gas was advanced by Nicor to third-parties when prices were higher than when prices were lower, meaning more high cost purchases would have been displaced had Nicor not been advancing gas to third-parties.

## RESPONSE TO NICOR

Contrary to Nicor's principle defenses in its Initial Brief, CUB-AG point out that this proceeding is a reconciliation of revenues and costs incurred under Nicor's PGA clause, and *not* a review of whether Nicor reliably delivered gas to customers. *See* Nicor Init. Br. at 1, 2, 3, 4, 8-9. CUB-AG state that it is also *not* a review of how Nicor operationally managed its storage fields, (*see* Nicor Init. Br. at 22-24, 27, 31), or whether it operated pursuant to tariffs on file (*see* Nicor Init. Br. at 8-9). CUB-AG aver that Nicor's primary tactic in this proceeding, however, is one of distraction and evasion. In its Initial Brief, CUB-AG state that Nicor repeatedly references actions and conclusions that are simply irrelevant to the Commission's review in this proceeding, in an attempt to create the appearance of propriety. For example, CUB-AG point to Nicor's emphasis on its claim that it safely and reliably operated its system to serve customer demand in an apparent attempt to show that it acted reasonably. According to CUB-AG, such information, however, does not aid the Commission in determining whether Nicor's gas purchasing practices were reasonable during 2003.

Furthermore, CUB-AG's disallowance recommendation does not pivot on – and CUB-AG do not argue that – Nicor “did not act in an operationally prudent manner,” (Nicor Init. Br. at 4), that Nicor did not serve its customers reliably and safely, or that it violated tariffs in effect at the time in its provision of Hub services. CUB-AG aver that Nicor's obligations to reliably and safely serve customers are regulated under wholly separate and irrelevant provisions of the Public Utilities Act (“PUA”) and applicable tariffs; Section 9-220 of the PUA – the only relevant and controlling section of the PUA – does not address those issues. CUB-AG argue that Nicor's actions regarding the reliability of its system and operational characteristics of its storage fields have little to no bearing on whether Nicor's gas costs were prudently incurred. The only reason to focus on those issues, say CUB-AG, is to obfuscate the focus of this proceeding.

Moreover, while the Commission must reconcile amounts collected under Rider 6 with Nicor's actual gas costs to ensure accuracy, CUB-AG maintain that this proceeding is also *not* a

challenge of Nicor's last in first out ("LIFO") accounting methodology, or an examination of whether Nicor charged ratepayers "fair, market prices." *Id.* Whether the rates charged through the PGA represent "fair, market prices" can only be determined by invoking the very same strictly prohibited hindsight analysis Nicor claims CUB-AG and Staff employ in recommending disallowances for Nicor's imprudent storage activity. CUB-AG argue that Nicor cannot have it both ways. In any event, say CUB-AG, neither the term "fair" nor "market" is mentioned in the statute and has no relevance to the Commission's review in this proceeding. CUB-AG note that the issue here is simply whether Nicor's gas costs were prudent and reasonable.

In its Initial Brief, CUB-AG note that Nicor mistakenly claims that one reason the Commission should reject CUB-AG's recommended disallowance is because the Commission "already has rejected an almost identical claim by Mr. Mierzwa in the GCPP Order." Nicor Init. Br. at 19. CUB-AG argue that Nicor is wrong that Mr. Mierzwa's recommendations in Docket No. 02-0067 were "almost identical" to his recommendations here. Before explaining the distinct differences, however, CUB-AG provide an instructive review of the history and facts surrounding that proceeding, since Nicor failed to provide them. CUB-AG note that the GCPP was filed by the Company in 1999 as an alternative regulation plan under Section 9-244 of the PUA. *Illinois Commerce Comm'n v. Northern Illinois Gas Company d/b/a Nicor Gas Company*, Docket Nos. 01-0705, 02-0067, 02-0725 (cons), Order (June 5, 2013) ("*GCPP Order*") at 1. CUB-AG explain that, before it requested approval of the program, however, Nicor had assembled an "Inventory Value Team" ("IVT") to analyze various strategies under which Nicor could gain a benefit from its significant stores of low cost LIFO storage gas. Docket Nos. 01-0705, 02-0067, and 02-0725 (cons), Mierzwa Dir., CUB Ex. 1.02 (Lassar Report) at 57. CUB-AG aver that the general conclusion of the IVT Report was the recommendation that Nicor pursue a performance-based rate ("PBR") mechanism, which would permit Nicor to realize a portion of its LIFO asset, if sold to the ratepayers, thorough a PBR sharing mechanism. *Id.* According to CUB-AG, not surprisingly, shortly after this report was generated internally, Nicor filed for approval of the GCPP. The IVT Report, however, never came to light in that docket (Docket No. 99-0127). Docket Nos. 01-0705, 02-0067, and 02-0725 (cons), Mierzwa Dir., CUB Ex. 1.0 2nd Rev. at 22:565-582. CUB-AG note that Nicor witnesses failed to reveal this key profit source in Docket No. 99-0127, despite this information being directly responsive to a CUB data request asking for "projections, analyses and studies prepared which examine the extent to which the Company may profit under its proposal." *Id.* Without the benefit of this critical information, the Illinois Commerce Commission ("Commission" or "ICC") approved the GCPP on November 23, 1999.

CUB-AG explain that, under the GCPP, each calendar year the Company's total actual annual purchased gas costs were compared with an annual gas cost benchmark, which reflected market prices for gas at the time the gas was sold to customers. *Id.* at 13:316-341. CUB-AG note that the benchmark included a storage credit adjustment that was meant to capture the seasonal price differential associated with gas that is purchased and stored during lower-cost non-peak summer periods and used later to serve demand during higher-cost peak winter periods. *Id.* CUB-AG point out that this is the same seasonal price differential discussed by Mr. Mierzwa in the instant case, (CUB. Ex. 2.0 at 3:45 (summer gas prices are typically lower than winter gas prices)), which Nicor witnesses Sherwood (tr. at 39:7-10) and Gulick (tr. at 115:12-15) refused to acknowledge exists. According to CUB-AG, the storage credit adjustment was the only component of the benchmark over which Nicor had any control. *Id.* By withdrawing less gas in

months when market index prices were low, claim CUB-AG, the utility could reduce the storage credit rate, raise the benchmark, and enable it to share in greater savings or fewer losses.

CUB-AG further explain that, shortly after the record in Docket No. 02-0067 was closed, (the Section 9-244 statutorily-mandated two-year review of the GCPP), CUB received a whistleblower fax in June 2002, alleging that Nicor was operating improperly under the GCPP. *GCPP Order* at 2. The record was then reopened, discovery was conducted (including depositions of various utility personnel), and additional testimony was filed by all parties. *Id.* Additionally, in response to the allegations contained in the whistleblower fax, the Company formed a Special Committee of the Board of Directors (“Special Committee”) to investigate Nicor’s GCPP activities. CUB-AG note that the Lassar Report found that Nicor’s GCPP activities had adverse consequences on ratepayers and recommended certain financial adjustments to eliminate the adverse consequences. The testimony from Commission Staff (Staff), CUB and the AG each identified multiple improper transactions and activity that warranted substantial refunds above the restated financial adjustments. In 2009, CUB-AG explain that Staff and Nicor entered into a stipulation that resulted in a \$64 million agreed refund to customers, intended to address eight separate issues Staff and CUB had identified as improper activity. *GCPP Order* at 4. CUB witness Mierzwa testified regarding the same eight issues, recommending disallowances for each in an amount substantially similar to Staff. *Id.* at 4-7.

Neither CUB nor the AG was a party to the stipulation because, in addition to the issues addressed in the stipulation, their witnesses identified other improper activity warranting refunds to make customers whole. Mr. Mierzwa testified that, in early 2001, Nicor reduced storage withdrawals in an attempt to manipulate its performance (the storage credit rate) under the PBR benchmark. Docket Nos. 01-0705, 02-0067, and 02-0725 (cons), Mierzwa Dir., CUB Ex. 1.0 2nd Rev. at 51:1403-1408. Mr. Mierzwa concluded that, at the time of this decision, it was not in the best interest of ratepayers to lower the storage withdrawal cycle because the cost of current purchases exceeded the projected costs of replacement supplies. *Id.* at 52:1426-1432; CUB Ex. 1.17. Mr. Mierzwa then calculated the impact of Nicor’s decision to lower the storage cycle in his recommended disallowance. While Mr. Mierzwa pointed out that Nicor’s Hub activity affected the Company’s storage inventory levels and the amount of gas available for withdrawal during 2001, this was only an aggravating factor demonstrating yet another way Nicor reduced storage withdrawal quantities to manipulate the benchmark. Docket Nos. 01-0705, 02-0067, and 02-0725 (cons), Mierzwa Reb., CUB Ex. 2.0 Rev. at 44:974-988. CUB-AG explain that the Hub activity Mr. Mierzwa identified was not the underlying theory of the storage manipulation adjustment. Rather, Nicor’s manipulation of the benchmark formula was the basis of the storage adjustment.

***The Facts and the Legal Standard Applicable to the Instant Proceeding Are Not the Same As Those Applied in the Nicor Gas Cost Performance Program Docket.***

CUB-AG note that, in the GCPP proceeding, Mr. Mierzwa alleged that Nicor reduced its storage injections in 2000 (specifically its NGPL contract storage injections) in an effort to capture additional LIFO value gas – the main reason Nicor created the GCPP. Mr. Mierzwa further concluded that Nicor deliberately suppressed storage withdrawals in 2001 in order to minimize its losses under the benchmark formula. According to CUB-AG, there is obviously

little similarity between his recommendations regarding an alternative rate scheme like the GCPP, where Nicor was found (by the Lassar Report) to have engaged in numerous improper transactions and agreed to \$64 million in refunds to address improper activity identified by Staff and CUB, and Mr. Mierzwa's recommendations regarding the imprudent Hub activity in this case. In this traditional prudence review, CUB-AG aver that the legal standard is prescribed (as set forth above) and differs from the standard applied in Docket No. 02-0067. In rejecting CUB's and the AG's recommended refunds in the GCPP case, the Commission cited to Sections 9-244 (c) and (d) of the PUA, which allows for Commission review to determine whether a program is meeting its objectives, and whether the utility is implementing the program in accordance with the Commission order approving the program. GCPP Order at 17. CUB-AG demonstrate that, as Nicor repeatedly stated throughout the GCPP review proceeding, prudence was not the relevant standard to be applied under Section 9-244. *See e.g.* GCPP Order at 7 ("Nicor argues that AG/CUB's proposed disallowances are improper to the extent they are premised upon the conclusion that Nicor acted imprudently in its reliance on purchases of gas instead of storage withdrawals in 2001. Nicor emphasizes that the Commission's Order approving the GCPP dispensed with the prudence standard as a measure of Nicor's performance under the GCPP.")

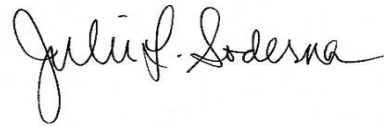
While the Commission questioned the intentions of the Company during the implementation of the GCPP, CUB-AG note that, ultimately, the Commission concluded that "no definitive evidence was presented to show that this component of the GCPP was not operated as intended." *Id.* The referenced component is the storage credit rate component of the benchmark formula, explained by CUB-AG above, which allowed Nicor to affect its performance under the benchmark by altering the amount of gas withdrawn from storage.

Here, say CUB-AG, Mr. Mierzwa concluded that Nicor imprudently engaged in discretionary Hub loans when that gas could have instead served to reduce sales customers' gas costs. CUB-AG argue that the facts and the law applicable to each proceeding are distinct and do not allow for a reasonable comparison. Nonetheless, aver CUB-AG, any attempt to compare these two proceedings results only in an unflattering picture of Nicor, and a revelation of previous illicit conduct. CUB-AG conclude that the facts surrounding the GCPP do not even come close to justifying the outrageous claim that "the Commission already has rejected an almost identical claim by Mr. Mierzwa," and any such suggestion should be rejected out of hand. CUB-AG clarify that under the GCPP it was Mr. Mierzwa's claim that Nicor artificially reduced storage withdrawals to earn a reward. Here, maintain CUB-AG, Nicor is claiming that lowering of storage withdrawals for Hub services is potentially harmful to storage operations, a conclusion with which CUB-AG challenge, but is nonetheless distinct from the facts and arguments presented in the GCPP docket.

Finally, CUB-AG discuss Nicor's reliance on its consultant-witness, Mr. Gulick, to fashion a "more plausible" explanation for why Nicor did not withdraw more storage to serve PGA demand (other than its desire to profit off of Hub loans at the expense of ratepayers). Nicor Init. Br. at 34. CUB-AG explain that Mr. Gulick conjectures either that Nicor had already committed to a planned dispatch, which likely included set quantities of firm pipeline purchases, or there was insufficient PGA demand. Nicor Init. Br. at 34, citing Nicor Ex. 7.0R at 15:304-306. Other than Mr. Gulick's unsupported guesswork, however, CUB-AG aver that Nicor presented no evidence that this was, in fact, the case. When questioned on cross-examination,

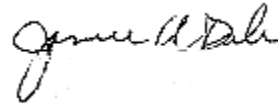
Mr. Gulick did not know what Nicor's obligations were with respect to the contracted firm gas, and admitted that he had not investigated whether Nicor was obligated to purchase that gas. March 17, 2015 tr. at 136:12-22-137:1-2. Thus, CUB-AG conclude that Mr. Gulick's claim that Nicor's spot gas purchases were not abnormally high in February and March, because of these firm supplies, (*id.* 25:461-465), should be disregarded. CUB-AG maintain that the simple truth is that, if Nicor had withdrawn more gas from storage in the winter of 2003 to serve customers, instead of engaging in discretionary Hub loans, it would have needed to purchase less flowing supplies and PGA costs would have been lower.

Respectfully submitted,



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Julie L. Soderna  
Director of Litigation  
CITIZENS UTILITY BOARD  
309 W. Washington, Ste. 800  
Chicago, IL 60606  
(312) 263-4282 x112  
(312) 263-4329 fax  
[jsoderna@citizensutilityboard.org](mailto:jsoderna@citizensutilityboard.org)



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People of the State of Illinois  
Lisa Madigan, Attorney General  
Janice A. Dale, Chief  
Public Utilities Bureau  
Illinois Attorney General's Office  
100 West Randolph Street, 11<sup>th</sup> Floor  
Chicago, IL 60601  
(312) 814-3736  
(312) 814-3212  
[jdale@atg.state.il.us](mailto:jdale@atg.state.il.us)

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